Industry Canada Industrie Canada

Q3 2010 VENTURE CAPITAL MONITOR

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A QUARTERLY UPDATE ON THE CANADIAN VENTURE CAPITAL INDUSTRY

Canadian high growth innovative small and medium-sized enterprises (SMEs) that commercialize research depend to a large extent on the venture capital (VC) industry for funding. Therefore, a strong VC industry is important for the growth of this segment of SMEs. The goal of this series is to provide current information about the VC industry in Canada. To this end, the series will track trends in investment activity, report on topical VC-related research and look at key technology clusters where VC investment is taking place.

INTRODUCTION

This issue discusses venture capital (VC) investment and fundraising activity in Canada during the third quarter of 2010, covering July through September 2010.

VC ACTIVITY OVERVIEW

Summary of investment and fundraising

A total of $264 million (108 deals) was invested in VC in Q3 2010 representing a 19 percent increase from the $222 million invested in Q3 2009, but falling short of the $335 million invested during the previous quarter (Table 1). Combined, VC investments during the first three quarters of 2010 have reached $909 million, an increase of 27 percent over the same period last year ($714 million) (Figure 1). Despite these gains, VC activity in Canada is still 17 percent short of the $1.1 billion invested in the same period in 2008.

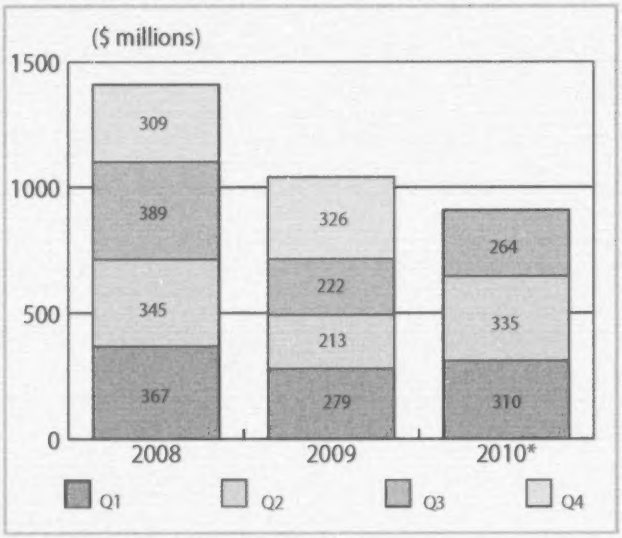
VC fundraising in Q3 2010 totalled approximately $35 million, a significant decline from the $118 million committed during the same period last year. Notably, over this period there were no major VC partnership closings; instead all new fundraising during this period was accounted for by labour sponsored venture capital corporations (LSVCCs) and other retail funds. As a result, VC fundraising levels in Canada to date in 2010 are approaching the historically low levels of 2009.

Table 1: VC investment and fundraising, Q3 2009 and Q3 2010

	Q3 2009	Q3 2010	% Change
	($ millions)		
Investment	222	264	19
Fundraising	118	35	-70

Source: Thomson Reuters Canada 2010.

Figure 1: VC Investment by quarter, Q1 2008 to Q3 2010



Source: Thomson Reuters Canada 2010.
* Through three quarters.

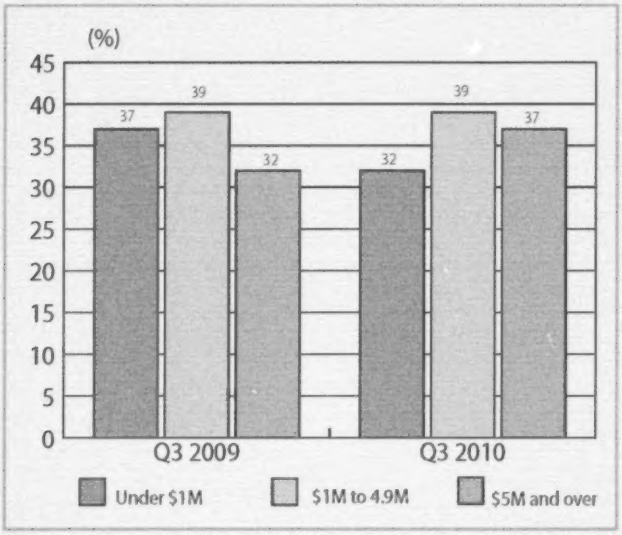
Canada

Deal size

Increase in year over year deal sizes

In contrast to disbursements, the total number of innovative firms backed with VC between July and September (108) remained the same year over year. However, average deal sizes grew in Q3 2010 ($2.4 million) from the Q3 2009 average ($2.0 million), thus accounting for the increase in disbursements. This is reflected in the share of deals greater than $5 million, as shown in Figure 2.

Figure 2: Distribution of VC investment by deal size, Q3 2009 and Q3 2010



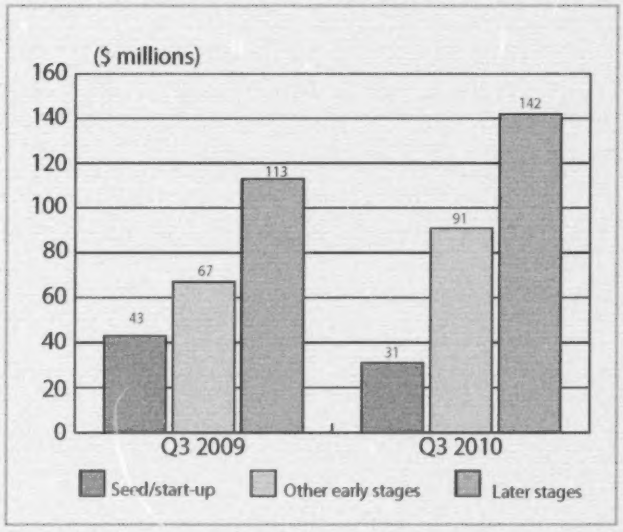
Source: Thomson Reuters Canada 2010.

Stage of development

Decrease in seed/start-up investment, but increase in large later stages

The increase in VC investment from Q3 2009 compared to Q3 2010 was concentrated in firms receiving later stage financing. Investment in companies at the seed and start-up stages of development declined from $43 million to $31 million over this period. Only three investments were made in seed-stage companies, compared to eight over the same period last year. The overall number of investments in later stage companies decreased but their value increased reaching $142 million (61 deals), up from $113 million (64 deals) in Q3 2009 (Figure 3).

Figure 3: VC investment by stage of development, Q3 2009 and Q3 2010



Source: Thomson Reuters Canada 2010.

New versus follow-on investments

New investments drop in the early-stages but increase in the later stages

There were 40 first-round VC deals in Q3 2010, which is slightly less than the average observed over the previous four quarters. First-time deals at the seed and start-up stages of development remained low with only 5 in Q3 2010, compared to the average of 12 over the previous four quarters. In contrast, at the later stages of development, first-time VC deals continued to increase. This may be attributed to the return of American VC funds and other foreign investors that have traditionally tended to invest in Canadian companies at the later stages of development (Table 2).

Table 2: The number of companies that received new and follow-on investment, Q3 2009 to Q3 2010

Investment		Q3 2009	Q4 2009	Q1 2010	Q2 2010	Q3 2010
New	Seed/ start-up	10	16	11	12	5
	Other early stages	6	3	6	6	4
	Later stage	30	23	23	29	31
	All	**46**	**42**	**40**	**47**	**40**
Follow-on	Seed/ start-up	9	19	12	11	9
	Other early stages	19	28	21	24	29
	Later stage	34	42	37	40	30
	All	**62**	**89**	**70**	**75**	**68**

Source: Thomson Reuters Canada 2010.

Type of investor

Increase across all types of investors

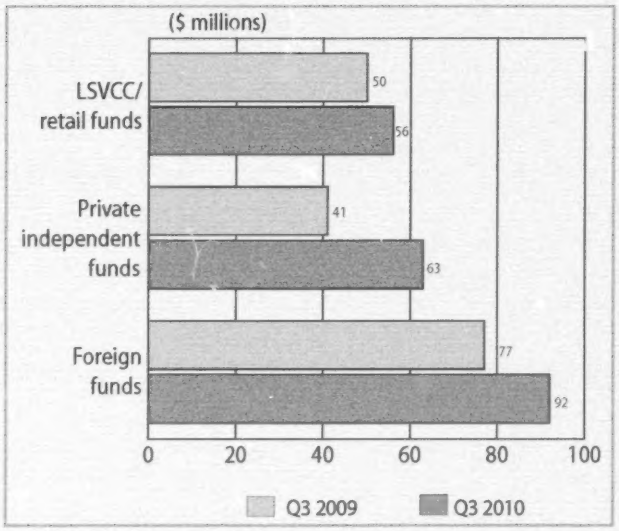
The three main types of Canadian VC investors increased their activity in Q3 2010 relative to the same quarter last year (Figure 4). The amount invested by foreign funds in Q3 2010 continued to recover since 2008, as Canadian companies attracted $92 million in foreign financing worth 35 percent of the Q3 2010 total. This represents a 19 percent increase over the same period last year.

Fundraising

No major VC partnership closings during Q3 2010

Canadian VC funds raised $35 million in Q3 2010, down from $118 million over Q3 2009. Most notably, no major private independent funds raised new funding during this period. Instead, nearly the entire supply of new funding was accounted for by LSVCCs and other retail funds. Consequently, the value of VC funds raised in Canada during the first three quarters of 2010 ($611 million) is nearing the historically low levels of 2009. Of particular note, retail funds are outpacing private funds in terms of fundraising so far in 2010.

Figure 4: Distribution of VC investment by type of investor, Q3 2009 and Q3 2010



Source: Thomson Reuters Canada 2010.

Regional distribution

Increase in VC investment in Ontario and British Columbia

In Q3 2010, the value of VC invested in two of Canada's three most populous provinces (Ontario and BC) increased compared to the same period in 2009, despite the number of companies receiving VC in BC declining by 47 percent (Table 3). The largest increase occurred in Ontario, where companies received $80 million more than over the same period in 2009 and as a result Ontario captured 46 percent of all Canadian disbursements in Q3 2010. Throughout 2009 and the first half of 2010, Quebec-based VC activity has most often led trends in the Canadian market. This was not the case in Q3 2010 as investment in Quebec companies dropped to $79 million down 22 percent from the $97 million invested over Q3 2009 (Figure 5).

Table 3: Number of companies receiving VC by province, Q3 2009 and Q3 2010

	Q3 2009	Q3 2010	% Change
British Columbia	15	8	-47
Alberta	5	7	40
Saskatchewan	2	1	-50
Manitoba	2	2	0
Ontario	30	34	13
Quebec	49	52	6
New Brunswick	1	2	100
Nova Scotia	2	2	0
Prince Edward Island	0	0	0
Newfoundland	2	0	-100
Territories	0	0	0

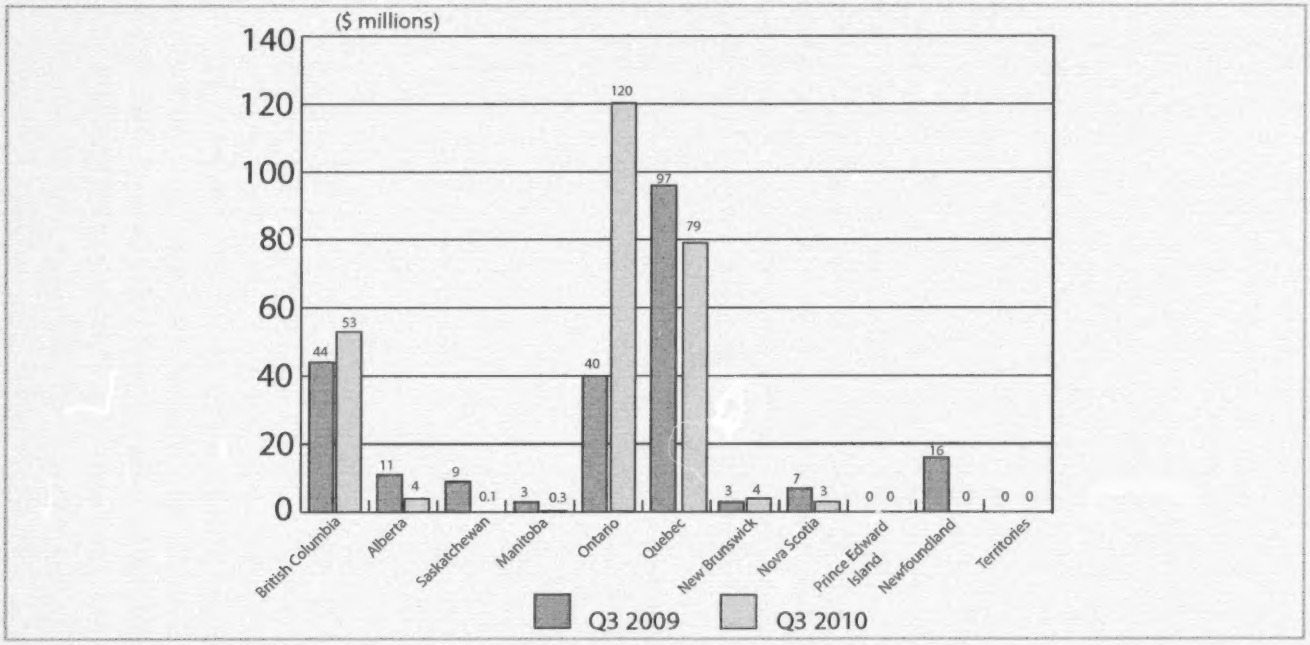
Source: Thomson Reuters Canada 2010.

Sector distribution

Increase in information technology and life sciences; fall in energy and environmental technologies

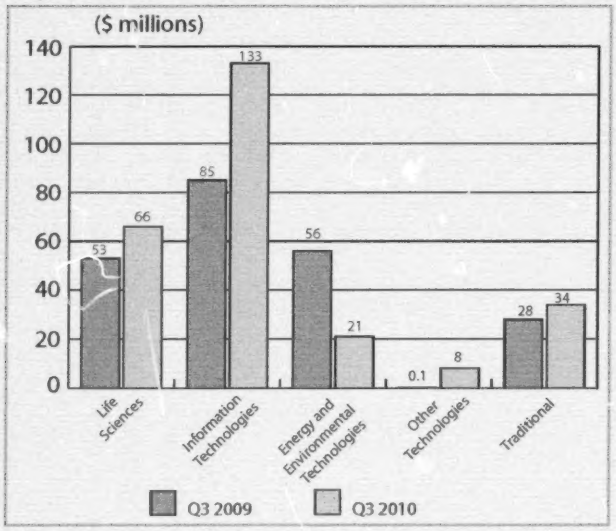
In Q3 2010, compared to the same period last year, there was an increase in VC investment in two of three major sectors: life sciences and information technology. The energy and environmental technologies sector had its lowest quarter since 2008 with approximately $21 million invested in companies. The fall in energy and environment technology investments compared to Q3 2009 was a result of smaller deal sizes in the sector as the average deal size fell from approximately $7 million to $2.7 million. The information technologies sector accounted for the majority of VC investment during the quarter (51 percent) (Figure 6).

Figure 5: Regional distribution of VC investment in Canada, Q3 2009 and Q3 2010



Source: Thomson Reuters Canada 2010.

Figure 6: VC investment by industry sector, Q3 2009 and Q3 2010



Source: Thomson Reuters Canada 2010.

GOVERNMENT ACTIVITIES

New federal funding for Ontario venture capital financed start-up companies

During Q3 2010, the Business Development Bank of Canada (BDC) made VC commitments totalling $11 million in seven companies. These financings were worth a total of $42.2 million including contributions by co-investors. This activity was in addition to any investment in private independent funds made by the BDC during the quarter (Table 4).

On October 15, 2010 Prime Minister Stephen Harper announced the launch of the $190 million Investing in Business Innovation program to be run through the Federal Economic Development Agency for Southern Ontario (FedDev Ontario). By providing eligible start-up businesses with repayable contributions of up to $1 million, the program is designed to accelerate the commercialization of new products, processes and practices by encouraging greater collaboration between start-up businesses and angel and venture capital investors.

Table 4: VC activities of the Business Development Bank of Canada, Q3 2010

	BDC	Co-investors	Total	Number of deals
	($ millions)			
Seed and start-up	1.5	1.5	3.0	1
Development	7.2	22.0	29.2	3
Later stage	2.3	7.7	10.0	3
Total	**11.0**	**31.2**	**42.2**	**7**

Source: Business Development Bank of Canada 2010.

To be considered eligible for the program, the business must be a start-up organization with less than 50 employees and have a signed draft term sheet from a recognized angel or venture capital investor. The program is also designed to leverage the investments of angel investor networks, and the organizations that represent them, to help attract new investors. Further details about this, and other FedDev Ontario programs that provide support for eligible small businesses, can be found online at http://www.feddevontario.gc.ca/eic/site/723.nsf/eng/home.

Nova Scotia Premier Darrell Dexter recently announced at the 2010 Power of Green Conference, that the province is exploring forming a privately operated venture capital fund, targeting opportunities throughout Atlantic Canada. Premier Dexter said the proposed venture capital fund is an opportunity for regional co-operation for a stronger and more prosperous Atlantic Canada. It is anticipated that once established the fund will raise capital from the private sector and other institutional investors.

NOTES

This publication is part of a series prepared by the Small Business and Tourism Branch. The branch analyses the financial marketplace and how trends in this market impact small businesses' access to financing. Current research is focused on high-growth firms, the aspects of both Canada's VC and general business environment that affect the success of these firms, and the key players in the risk-capital market (for example, VC firms and angels).

The Small Business and Tourism Branch is also responsible for the Small and Medium-Sized Enterprise Financing Data Initiative (SME FDI). The SME FDI is a comprehensive data-collection program on SME financing in Canada. In partnership with Statistics Canada and Finance Canada, Industry Canada reports on the supply of and demand for financing by small and medium-sized businesses. Further information and statistical findings and reports are available at www.sme-fdi.gc.ca.

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